DEPARTMENT OF STATE REVENUE

04-20090218.LOF

Letter of Findings Number: 09-0218
Sales and Use Tax
For Tax Years 2005, 2006, and 2007

NOTICE: Under IC § 4-22-7-7, this document is required to be published in the Indiana Register and is effective in its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Tax Administration – Proposed Assessment.

Authority: IC § 6-2.5-1-1 et seq.; IC § 6-2.5-2 et seq.; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-3-5; IC § 6-8.1-5-1; Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); In re J.S., 906 N.E. 2d 226 (Ind. Ct. App. 2009).

Taxpayer protests the validity of the proposed assessment.

II. Sales and Use Tax – Imposition.

Authority: IC § 6-2.5-1-1 et seq.; IC § 6-2.5-1-8; IC § 6-2.5-1-24; IC § 6-2.5-1-27; IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-4-8; IC § 6-8.1-5-1; 45 IAC 2.2-4-2; Sales Tax Information Bulletin 8 (May 2002); Revenue Ruling 2008-14ST (December 3, 2008).

Taxpayer protests the assessments of use tax on various purchases of tangible personal property.

III. Tax Administration – Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2.

Taxpayer protests the imposition of a ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an Indiana financial institution. Pursuant to an audit, the Indiana Department of Revenue (Department) assessed Taxpayer use tax, interest, and penalty on tangible personal property which Taxpayer purchased and used in Indiana during 2005, 2006, and 2007. Taxpayer timely protests the assessments. A hearing was held. This Letter of Findings ensues. Additional facts will be provided as necessary.

I. Tax Administration – Proposed Assessment.

DISCUSSION

After the audit, the Department assessed use tax, interest, and penalty on Taxpayer's purchases of tangible personal property because Taxpayer did not pay sales tax at the time of the purchases. Taxpayer timely protested the assessments. Taxpayer raised a preliminary issue that the Department's proposed assessments, the AR-80s, are not valid because no "assessment" was ever issued.

As a threshold issue, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Indiana imposes a sales tax on retail transactions and a complementary use tax on tangible personal property that is stored, used, or consumed in the state. IC § 6-2.5-1-1 et seq. In general, all purchases of tangible personal property are subject to sales and/or use tax. An exemption from use tax is granted for transactions where sales tax was paid at the time of the purchase pursuant to IC § 6-2.5-3-4.

The AR-80s first informed Taxpayer that it may owe tax and that it has a right to protest within forty-five (45) days if Taxpayer did not agree with the Department's proposed assessments. Next, the "Summary of Amount Due" column of the AR-80s listed the amount which Taxpayer owed "Original Tax (Sales)" for 2005, 2006, and 2007. Meanwhile, the enclosed audit summary explained to Taxpayer that it owed use tax for these years because Taxpayer failed to pay sales tax at the time of the purchases.

Taxpayer, referring to IC § 6-8.1-5-1, believes that an audit summary sets out the conclusions of the auditor's findings, and is not a proposed assessment. Taxpayer also believes that the Department's audit concluded that Taxpayer did not have any sales tax liabilities and, therefore, the AR-80s erroneously assessed sales tax. Thus, Taxpayer believes that the AR-80s, the "assessments," were invalid. Taxpayer maintained that sales tax is different from use tax because they are different concepts and in different sections of Indiana statutes, IC § 6-2.5-2 regulates sales tax while IC § 6-2.5-3 regulates use tax. Taxpayer thus urged the Department to invalidate the proposed assessment because the Department's audit stated that Taxpayer did not owe sales tax for these years.

Taxpayer is mistaken. The Indiana Code lists sales tax under IC § 6-2.5-2 and immediately follows with use tax under IC § 6-2.5-3. The drafters of the Indiana statutes considered taxes, either sales and/or use tax, on tangible personal property correlatively. Intending to tax tangible personal property only once, the General Assembly addressed circumstances where retail transactions occurred but Indiana was not able to collect the sales tax and, therefore, the General Assembly imposed a complementary tax, use tax. Under the Indiana statutes, when a purchaser pays sales tax on a purchase, the purchaser has a credit (exemption) against the use

tax pursuant to IC § 6-2.5-3-4 or IC § 6-2.5-3-5. However, when a purchaser fails to pay sales tax on a purchase, use tax is due on the purchase and the purchaser must self-assess and remit the use tax to the Department.

In this instance, Taxpayer received the AR-80s, proposed assessments which were generated by the Department's automated computer system, stating "Original Tax (Sales)." In addition to the AR-80s, Taxpayer also received the enclosed audit summary explaining to Taxpayer what the auditor's findings were. Page 3 to the audit summary, Explanation of Adjustments, in pertinent part, states:

ADJUSTMENT TO USE TAX

An examination of the taxpayer's depreciation schedule, detailed general ledger reports and purchase invoices revealed that the taxpayer had purchases where they did not pay sales tax at the time of purchase and they did not self-assess and remit use tax on their sales/use tax returns. (Emphasis added).

Accordingly, Taxpayer should have paid sales tax (i.e., the original tax) at the time of the purchases. Since Taxpayer did not pay sales tax, pursuant to IC § 6-2.5-3-2 and IC § 6-2.5-3-4, Taxpayer should have self-assessed and remitted use tax to the Department afterwards. Taxpayer did not pay the original tax (i.e., sales tax), nor did it self-assess and remit use tax. Thus, the audit correctly stated use tax due. By sending Taxpayer the AR-80s and enclosing a copy of the audit summary, Taxpayer thus was on notice and should not have been confused as to the tax liabilities being assessed.

Even if, for the purpose of discussion, the AR-80s mistakenly stated "sales tax" instead of "use tax," these were obviously clerical or scrivener's errors and they are harmless. In re J.S., 906 N.E. 2d 226, 235 (Ind. Ct. App. 2009) (upholding the trial court's Order to terminate the parental rights because the trial court correctly applied the proper standard complying with the termination statute and finding that the court's "use of the word 'have' for 'will' is merely a scrivener's error and does not warrant reversal of the termination decision.") Taxpayer received both AR-80s and the audit summary at the same time in the same package as a result of the audit. Additionally, the amounts of tax due in the AR-80s for these years were identical with the tax liabilities of each year in the audit summary. Taxpayer was or should have been on notice and was aware of its tax liabilities. After it received both AR-80s and the audit summary, Taxpayer timely protested the proposed assessments. Taxpayer was on notice, timely protested, as well as requested an administrative hearing to address its protest. As a result, the hearing was held. Taxpayer was not deprived of its due process right.

FINDING

Taxpayer's protest is respectfully denied.

II. Sales & Use Tax – Imposition.

DISCUSSION

The Department's audit assessed Taxpayer use tax on its purchases of the credit reports from credit repositories and purchases of credit risk models because Taxpayer did not pay sales tax at the time of the transactions. Taxpayer claimed that it had not purchased taxable tangible personal property but rather that it subscribed to non-taxable services.

Indiana imposes a sales tax on retail transactions and a complementary use tax on tangible personal property that is stored, used, or consumed in the state. IC § 6-2.5-1-1 et seq.

IC § 6-2.5-2-1 provides:

(a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.

(b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

IC § 6-2.5-3-2 provides:

(a) An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.

Accordingly, all sales of tangible personal property are taxable. An exemption from the use tax is granted for a transaction where the gross retail tax ("sales tax") was paid at the time of purchase pursuant to IC § 6-2.5-3-4.

A. Credit Reports

1. Credit Repositories

The Department's audit assessed use tax on Taxpayer's purchases of credit reports from credit repositories. Taxpayer claimed that it subscribed to services, and, as services, the transactions were not subject to sales and/or use tax. Taxpayer, alternatively, claimed that the General Assembly does not intend to impose sales and/or use tax on credit reports.

45 IAC 2.2-4-2, in relevant part, states:

(a) Professional services, personal services, and services in respect to property not owned by the person rendering such services are not "transactions of a retail merchant constituting selling at retail", and are not subject to gross retail tax. Where, in conjunction with rendering professional services, personal services, or other services, the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant constituting selling at retail unless:

(1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from

tangible personal property;

(2) The tangible personal property purchased is used or consumed as a necessary incident to the service;

(3) The price charged for tangible personal property is inconsequential (not to exceed 10 [percent]) compared with the service charge; and

(4) The serviceman pays gross retail tax or use tax upon the tangible personal property at the time of acquisition.

Notably, only when the four requirements mentioned above are fulfilled, is a taxpayer entitled to the exemption pursuant to 45 IAC 2.2-4-2.

Sales Tax Information Bulletin 8 (May 2002), in relevant part, states:

F. Sale of Miscellaneous Data:

The sale of statistical reports, graphs, diagrams or any other information produced or complied [sic] by a computer and sold or reproduced for sale in substantially the same form as it is so produced is considered to be the sale of tangible personal property unless the information from which such reports was compiled was furnished by the same person to whom the finished report is sold.

The charge for reports compiled by a computer exclusively from data furnished by the same person for whom the data is prepared is considered to be for a service and is not subject to sales or use tax unless it is part of a unitary transaction which is subject to sales or use tax.

To support its protest, Taxpayer submitted copies of the master agreements, pricing schedules, and order forms exchanged between Taxpayer and its vendor-repositories, invoice samples, and credit report samples. The contents of the credit reports consist of (1) Summary of Taxpayer's customers' credit information (including quantity and types of credit cards, mortgages and loans, repo, collection, and bankruptcy filings), (2) Credit scores, (3) Credit Analysis, (4) Special Messages, (5) Model Profile, (6) Credit Summary, and (7) Trades (including the customers' credit history in detail, such as, but not limited to, credit cards issued by banks, department stores, retail stores and the balances). The credit reports also included the customer's individual and household monthly income, revolving debt payments and installment loan payments. All the contents of the credit reports were compiled and furnished by the vendor-repositories of consumer credit data.

Taxpayer, however, specifically directed the Department's attention to one of the credit scores which Taxpayer claimed it had purchased under a different agreement from a vendor which specializes in credit risk models. (Please see the discussion in Part B.)

With a username and password provided by the vendor-repositories, Taxpayer was permitted to search and retrieve the credit report it wanted by using the information which its customers (applicants) provided when they applied for loans and/or mortgages, such as the applicant's name, social security number, address, and/or phone number. Additionally, Taxpayer could print out the reports and/or save the credit reports in a computer.

Upon Taxpayer's demand, i.e., entering the search term or terms, the vendor-repositories electronically transferred the credit reports to Taxpayer and Taxpayer then paid the vendor-repositories for the credit reports based on the volume of the reports Taxpayer purchased. Taxpayer received the credit reports, either in printout form, by electronically storing them in the computer, or simply by viewing the electronically generated reports. Taxpayer did not contract with the vendor to perform and provide a service, i.e. collect specific and customized information on its behalf. Instead, Taxpayer purchased the completed products, i.e., credit reports, after the vendor-repositories compiled and furnished the information in the report formats. Pursuant to 45 IAC 2.2-4-2 and Sales Tax Information Bulletin 8, the credit reports are tangible personal property and, therefore, taxable.

Taxpayer stated that it believes that the Indiana legislature did not intend to impose sales and/or use tax on "digital credit reports" even though the legislature passed legislation to tax certain "digital" tangible personal property acquired in retail transactions. Taxpayer further argued that the new laws "should only apply to products that traditionally have been transferred in the form of tangible personal property (e.g. records, audio cassettes, CDs, video cassettes, DVDs, and bound books) but [that] through technological advances have become available by electronic media." Thus, Taxpayer maintained that the "General Assembly's apparent intent is to maintain the taxability of that which historically has been subject to sales and use tax–not to tax previously nontaxable services."

Taxpayer correctly stated that the General Assembly intended to impose sales and/or use tax on tangible personal property, but not on services. Its argument, however, misconstrued what constitutes "service" and/or "tangible personal property."

IC § 6-2.5-1-27 states:

"Tangible personal property" means personal property that:

(1) can be seen, weighed, measured, felt, or touched; or

(2) is in any other manner perceptible to the senses.

The term includes electricity, water, gas, steam, and prewritten computer software.

45 IAC 2.2-4-2 and Sales Tax Information Bulletin 8 further clarify that credit reports, which the vendor-repositories compiled into individual credit information, in report formats, and that sold the reports "in substantially the same form as [they are] so produced" are tangible personal property. Thus, the credit reports historically have been subject to sales and/or use tax.

Taxpayer purchased the completed products, i.e., credit reports, after the vendor-repositories compiled and furnished standard information in the report formats. Upon placement of Taxpayer's purchase orders, the vendor-repositories electronically delivered to Taxpayer the credit reports. Pursuant to 45 IAC 2.2-4-2 and Sales Tax Information Bulletin 8, the credit reports are tangible personal property and, therefore, taxable. Since Taxpayer did not pay sales tax at the time of the purchases, the use tax is properly imposed.

2. PACER Service Center

The Department's audit assessed the use tax on Taxpayer's purchases of information concerning federal court cases, such as compilations of case information including cause of action and the nature of court filings. The Department mistakenly identified these transactions as purchases of credit reports. This Letter of Findings clarifies that the Pacer Service Center transactions are not correctly identified. Upon Taxpayer's request, the Pacer Service Center charged Taxpayer a nominal fee based on the number of pages and electronically delivered the documentation to Taxpayer.

The Pacer Service Center is the Administrative Office of the U.S. Courts. As a government agency, when the Pacer Service Center performs its government functions, it is not a retail merchant according to IC § 6-2.5-1-8 and IC § 6-2.5-4-8. Therefore, the transaction is not a retail transaction under IC § 6-2.5-4.

In short, Taxpayer's purchases from the Pacer Service Center are not subject to sales and/or use tax.

B. Vendor of Credit Risk Models

The Department's audit assessed, and Taxpayer protested, the use tax on Taxpayer's purchases of the credit risk models from a vendor (Vendor).

In addition to a standard credit score provided within the credit report, Taxpayer maintained that it contracted with the Vendor to "customize" a credit score by utilizing the Vendor's risk models. Taxpayer indicated that the Vendor provided Taxpayer with a guideline of characteristics to be included in computation of the credit score. Taxpayer stated that it then modified the factors provided in the guideline and assigned weights to the various factors, including, but not limited to, the length of time at the current residence and term of employment. Taxpayer then applied the information it received from the credit-repositories (i.e., credit reports) and/or applicants to the Vendor's risk models to compute the credit score. Taxpayer thus claimed that it subscribed to a service from the Vendor, and, therefore, as a service, it was not subject to sales and/or use tax. In the alternative, Taxpayer argued that the Vendor's risk models were similar to the "virtual goods" stated in the Department's Revenue Ruling 2008-14ST (December 3, 2008). Taxpayer thus claimed that pursuant to the Revenue Ruling 2008-14ST, the Vendor's risk models, like the "virtual goods," are not tangible personal property, and the transactions were not subject to sales and/or use tax as a result.

IC § 6-2.5-1-24 states:

> Subject to the following provisions, "prewritten computer software" means computer software, including prewritten upgrades, that is not designed and developed by the author or other creator to the specifications of a specific purchaser:
>
> (1) The combining of two (2) or more prewritten computer software programs or prewritten parts of the programs does not cause the combination to be other than prewritten computer software.
>
> (2) Prewritten computer software includes software designed and developed by the author or other creator to the specifications of a specific purchaser when it is sold to a person other than the purchaser.
>
> (3) If a person modifies or enhances computer software of which the person is not the author or creator, the person is considered to be the author or creator only of the person's modifications or enhancements.
>
> (4) Prewritten computer software or a prewritten part of the software that is modified or enhanced to any degree, where the modification or enhancement is designed and developed to the specifications of a specific purchaser, remains prewritten computer software. However, where there is a reasonable, separately stated charge or an invoice or other statement of the price given to the purchaser for such a modification or enhancement, the modification or enhancement is not prewritten computer software.

Sales Tax Information Bulletin 8 (May 2002), in relevant part, further states:

> I. Definitions
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> ...
>
> B. Computer Software:
>
> A software program is one in which instructions and routines (programs) are determined necessary to program the customer's electronic data processing equipment to enable the customer to accomplish specific functions.
>
> The software may be in the form of:
>
> 1. System programs (except for the instruction codes which are considered tangible personal property in paragraph 2 above) –programs that control the hardware itself and allow it to compile, assemble, and process application programs.
>
> 2. Application programs – programs that are created to perform business functions or control or monitor processes.
>
> 3. Pre-written programs (canned) – programs that are either system programs or application programs and are not written specifically for the user.

4. Custom programs – programs created specifically for the user.

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II. Sales and Use Tax application

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B. Transactions Involving Computer Software:

As a general rule, transactions involving computer software are not subject to Indiana Sales or Use Tax provided the software is in the form of a custom program specifically designed for the purchaser.

Pre-written programs, not specifically designed for one purchaser, developed by the seller for sale or lease on the general market in the form of tangible personal property and sold or leased in the form of tangible personal property are subject to tax irrespective of the fact that the program may require some modification for a purchaser's particular computer. Pre-written or canned computer programs are taxable because the intellectual property contained in the canned program is no different than the intellectual property in a videotape or a textbook.

Example One: A software retailer that sells prepackaged programs for use with home television games or other personal computer equipment is considered to be a vendor of tangible personal property and is required to collect sales tax on the sales price of such property.

Example Two: A firm develops and sells pre-written application programs which are available to any of the firm's potential customers. The sale of these programs are subject to tax.

Taxpayer's documentation shows that Taxpayer purchased "predeveloped pooled models" and the Vendor charged Taxpayer based on the volume of applications. According to Taxpayer's documentation, the "predeveloped model" is "an empirically derived Application Risk Model, tailored for certain predetermined industries/portfolios." The Vendor, using its own database of credit information, assembled various typical industry portfolios and developed a number of models which were available to any purchaser. Taxpayer contracted with the Vendor for four of its "predeveloped models." Thus, the Vendor predeveloped the risk models, are pre-written software programs, not "visual goods," which were available to be sold to any purchaser. The Vendor also provided the purchaser with a manual (guideline of characteristics) which the purchaser (user) of the predeveloped models can assign risk factors when using the program and charged Taxpayer based on the volume of the applications. Pursuant to IC § 6-2.5-1-24 and Sales Tax Information Bulletin 8, the Vendor's risk models are pre-written or canned computer programs, and, therefore, are subject to sales and/or use tax.

Since Taxpayer did not pay sales tax at the time of the transaction, the use tax is properly imposed.

FINDING

Taxpayer's protest on the purchases from the PACER Service Center is sustained. However, Taxpayer's remaining protest is respectfully denied.

III. Tax Administration – Negligence Penalty.

DISCUSSION

Taxpayer also protests the imposition of the negligence penalty.

Pursuant to IC § 6-8.1-10-2.1, the Department may assess a ten (10) percent negligence penalty if the taxpayer:

(1) fails to file a tax return;

(2) fails to pay the full amount of tax shown on the tax return;

(3) fails to remit in a timely manner the tax held in trust for Indiana (e.g., a sales tax); or

(4) fails to pay a tax deficiency determined by the Department to be owed by a taxpayer.

45 IAC 15-11-2(b) further states:

"Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The Department may waive a negligence penalty as provided in 45 IAC 15-11-2(c), in part, as follows:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

(1) the nature of the tax involved;

(2) judicial precedents set by Indiana courts;

(3) judicial precedents established in jurisdictions outside Indiana;

(4) published department instructions, information bulletins, letters of findings, rulings, letters of advice,

etc.;

(5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

Taxpayer failed to provide sufficient documentation establishing that its failure to pay tax or timely remit tax was due to reasonable cause and not due to negligence.

FINDING

Taxpayer's protest on the imposition of the negligence penalty is denied.

SUMMARY

For the reasons discussed above, Taxpayer's protest on the purchases from the PACER Service Center is sustained. However, Taxpayer's remaining protest is respectfully denied.

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